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C O N F I D E N T I A L SECTION 01 OF 02 HO CHI MINH CITY 000143

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TAGS: EFIN ECON PGOV EINV VM
SUBJECT: (C) VIETNAM CONSIDERS CAPITAL CONTROLS TO SLOW SOARING STOCK MARKET

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¶1. (C) Summary: The skyrocketing Saigon Stock Exchange has gone ballistic since President Bush visited the trading floor in November. The investment frenzy has boosted the Vietnam Stock Exchange Index by about 80 percent since the President's visit, with 44 percent appreciation since January 1. Market insiders believe the funds flowing into equities are divided about equally between foreign and domestic investors. The GVN is concerned about the pace and sustainability of the market and is considering new regulations on securities trading and capital controls. In the last few days, leading investment banks have issued warnings of a possible Thailand scenario. The rapid restructuring of the Vietnamese economy; its post-APEC and WTO emergence on the world stage; and accelerating trade and FDI flows, make it difficult to assess either the underlying value or inherent risk of Vietnamese securities. Our contacts in the investment community observe that the authorities do not want to choke the markets, since they hope to list the shares of major GVN-owned companies this year. They are concerned, however, about rapid capital flows that could have a significant impact on reserves, money supply, exchange rate and the real economy. End Summary.

¶2. (U) The Ho Chi Minh City Securities Trading Center continues to climb from its 2006 records. The VN Stock Exchange Index (VN Index) was up 145 percent in 2006, and rose an additional 48 percent between January 1 and February 7. A year ago market capitalization was USD 460 million; now it is close to USD 20 billion. The number of listed companies has grown from 39 one year ago to over 100. The rapid rise of the market was initiated, at leas in part, by the late 2005 GVN decision to increase foreign ownership limits in listed companies to 49 percent from 30 percent.

¶3. (SBU) The change in ownership limits sparked foreign interest in Vietnam. In an atmosphere of strong global liquidity and tolerance for risk, foreign capital has flooded into Vietnam. In addition to accounting for about half the investment in Vietnamese securities markets, foreign investors play a major role in Vietnam's nascent bond market. One HCMC fund manager estimated that 70 percent of GVN debt is held abroad with substantial, leveraged investment that is banking on the stability of the VND and two to three percentage points of premium between dollar and dong interest rates. Investors' interest in Vietnam was piqued by the APEC summit and WTO accession. Resident Bush's visit to the HCMC stock exchange floor was credited with starting another market surge.

¶4. (U) Foreign interest in equities sparked renewed interest from domestic investors. Economists and bankers have always thought that private wealth in Vietnam was underestimated.

Traditionally, Vietnamese have literally buried their savings in gold or invested in real estate. While gold imports and sales have been climbing, gold is no longer the central store of value it once was, especially with world prices at high levels. Likewise, speculative activity in real estate has been limited in the last couple of years through a variety of government regulations. As a result, high net-worth Vietnamese discovered the stock market in 2006.

¶5. (C) Vietnam's markets are being influenced by domestic liquidity as well as global liquidity. With a stable, managed exchange rate and booming exports, Vietnam's central bank is creating substantial liquidity. At the same time, remittances are putting billions of dollars in the pockets of Vietnamese. Furthermore, some experts are skeptical of Vietnam's balance of payments figures, believing that the current account has been in surplus, rather than deficit, for several years. One analyst estimates the difference between the reported and actual current account could be as much as four to five percentage points of GDP. In short, experts believe there is substantial uncounted liquidity in the economy.

¶6. (C) According to analyses by investment banks such as HSBC and Credit Suisse, Vietnam's equities are selling at 40 times previous year's earnings, a high - but not unprecedented - level for an emerging economy. While some see this as signs of a bubble, on the other hand, corporate results are benefiting from structural reforms as leading companies become progressively more market-oriented, especially banks. HSBC forecasts 2006 annual earnings to have grown an average of 30 percent market wide, with some major outperformers. Some observers look at the rapid run-up of valuations as an extended, but one-time, re-adjustment of valuations of the Vietnamese economy. Whatever the case, the most knowledgeable market players agree that both valuations and risk are highly subjective. Whatever the valuations, clearly a lot of the money flowing in is not looking at valuations but playing the momentum. We heard one story of a woman who made a tidy sum in the market and donated it to a Buddhist monastery, only to have the monks return three-quarters

of it to her for re-investment in the market.

¶7. (C) As the market has heated up, the GVN has become increasingly concerned. Towards the end of January, GVN officials like the chairman of the State Securities Commission (SSC) tried to talk down the market. However, in the last week the GVN has let it be known that it is looking at both regulatory and capital controls as means of slowing down the stock exchange. On January 29, the GVN published some conclusions issued by Prime Minister Nguyen Tan Dung. He stated that foreign ownership limits on listed companies would not be raised in the near term, that market authorities should tighten the supervision of the stock market, securities companies and investment funds, and that mechanisms to control fund flows should be developed.

¶8. (C) On February 2 the GVN circulated within the financial community a revised draft circular that would regulate the activities of investment funds. The circular, which was shared with us in confidence, would be part of a raft of implementing regulations for the new Securities Law. One expert stated the draft would "raise the bar substantially" for financial service firms. Among its measures, the circular would require offshore funds to transform local representative offices into licensed branches in order to trade in the Vietnamese market. As branches, the funds would have to meet more robust reporting and management requirements. The circular also proposes that foreign institutional and individual investors be required to invest only through foreign fund management companies and their branches ed in country. The purpose of this measure, the analyst said, was to discourage hot money investors from moving money in and out of Vietnam.

¶9. (C) About the same time the revised regulations were being circulated, the governor of the State Bank of Vietnam (SBV)

reportedly proposed to PM Dung that capital controls be placed on foreign funds flowing out of Vietnam. In what local experts are calling an intentionally badly-kept secret, SBV governor Le Duc Thuy suggested that foreign investors be required to wait 12 months before being allowed to take share sale proceeds out of Vietnam. Other capital control measures reportedly being mulled include a capital gains tax, which Vietnam currently does not have, and an announcement period, in which investors would be able to transfer funds out of the country 30 days after declaring their intention to do so. HCMC's financial community has proposed to the GVN that an alternative might be a progressive levy on outflows. Under this mechanism, capital leaving the country would be taxed based on the amount of time it spent in Vietnam, with funds in the country a short period of time taxed at a rate higher than funds in the country for a longer period of time.

¶10. (SBU) Foreign investors have responded quickly to these developments. Vietnam-related funds listed in London dropped by three percent on February 7, according to one analyst. The VN Index lost four percent on February 8 and a further two percent in trading February 9. HSBC, Deutsche Bank, Credit Suisse, and JPMorgan have issued warnings to investors. A number of people in the investment business are in a tizzy about Vietnam becoming the next Thailand and losing the Vietnam market just as it becomes hot.

¶11. (C) Comment: Vietnam's economy and financial markets remain small in comparison with other emerging markets and relative to the size of recent flows. In round terms, Vietnam's 2006 GDP was USD 60 billion, exports were USD 40 billion, and imports were USD 44 billion. The capitalization of the Vietnamese stock market was almost USD 500 million in early 2006, and it grew to USD 17 billion over the course of the year. An inflow of USD 2 billion, which may well have occurred in January, would represents a five percent increase in Vietnam's money supply, according to one expert. Already, the currency is appreciating in nominal terms, for the first time in a number of years. And with inflation running at six percent, the real appreciation is even sharper. Further, we understand the actual exchange rate on large transactions is increasing as banks reportedly and unofficially charge extra fees to gather large quantities of VND. With poorly developed financial markets, a banking system that is dedicated overwhelmingly to allocating credit to state-owned enterprises, a managed exchange rate regime, and a minimally developed bond market, the GVN does not see a lot of monetary policy tools at its disposal. It appears that monetary stability, more than export competitiveness and the exchange rate, is driving GVN policy at this point. End Comment.
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